IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

WRS, INC., d/b/a WRS MOTION PICTURE LABORATORIES, a corporation, Plaintiff, v. PLAZA ENTERTAINMENT, INC., a corporation, ERIC PARKINSON, an individual, CHARLES BERNUTH, an individual, and JOHN HERKLOTZ, an individual, Defendants.	: : : : : : : : : : : : : :	CIVIL ACTION NO. 00-2041

BRIEF IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT
OR, ALTERNATIVELY, MOTION FOR PARTIAL SUMMARY JUDGMENT

Defendant, JOHN HERKLOTZ ("Defendant Herklotz"), by his attorneys, BURNS, WHITE & HICKTON, LLC, sets forth the following Brief in Support of Motion for Summary Judgment or, alternatively, Motion for Partial Summary Judgment:

FACTS

The facts set forth in Defendant Herklotz's Motion for Summary Judgment are incorporated herein by reference.

ARGUMENT

I. ***The October 12, 1998 Services Agreement Materially Modified the Creditor-Debtor Relationship, Substantially Increasing Herklotz's Risk, Thereby Discharging His Obligation.***

Throughout the course of this lawsuit, it has been alleged that Defendant Herklotz is a guarantor of Plaza's debt to WRS. Initially, the terms "suretyship" and "guaranty" must be clarified. 8 P.S. § 1[1] states in full:

> Every written agreement hereafter made by one person to answer for the default of another shall subject such person to the liabilities of suretyship, and shall confer upon him the rights incident thereto, unless such agreement shall contain in substance the words: "This is not intended to be a contract of suretyship," or unless each portion of such agreement intended to modify the rights and liabilities of suretyship shall contain in substance the words: "This portion of the agreement is not intended to impose the liability of suretyship."

The May 6, 1998 document signed by Defendant Herklotz is properly a suretyship in that the document does not contain the above-referenced statutory language. Therefore, to avoid further confusion, the May 6, 1998 document shall be referred to in this Brief a suretyship.

There is no allegation that Defendant Herklotz was compensated by Plaza or anyone else for executing the suretyship agreement at issue in this matter. Defendant Herklotz is therefore a " gratuitous surety". Pennsylvania courts have consistently differentiated between gratuitous (uncompensated) sureties and

[1] The suretyship document requires application of Pennsylvania law.

compensated sureties. J.F. Walker Co., Inc. v. Excalibur Oil Corp., Inc., 792 A.2d 1269 (Pa. Super. 2002).

"Where, without the surety's consent, there has been a material modification in the creditor-debtor relationship, a gratuitous surety is completely discharged." Continental Bank v. Axler, 510 A.2d 726, 729 (Pa. Super. 1986). A material modification in the creditor-debtor relationship consists of a significant change in the principal debtor's obligation to the creditor that in essence substitutes an agreement substantially different from the original agreement on which the surety accepted liability. Continental Bank, at 729. In Continental Bank, co-sureties, the Axlers, contended that their co-suretyship was discharged when they sold their interest in the debtor corporation, North Broad, to a non-surety. The Pennsylvania Superior Court determined that the co-sureties waived all notices of North Broad's adverse change of financial condition and any other factors that materially increased their risk, and that they would be obligated to any other company that might be a successor to North Broad. While this was a material modification increasing their risk, the Axlers had waived both notice and increasing risk in their suretyship agreement.

Turning to the facts of this case, Defendant Herklotz executed the May 6, 1998 suretyship agreement allegedly obligating him for Plaza's outstanding debts to induce WRS to extend credit to Plaza. The suretyship agreement did not waive increased risk of the surety, and in fact does not contain the words "increased risk". The suretyship was executed on the basis of the business relationship that WRS and Plaza had enjoyed since 1996, the updated account application, additional security to WRS and WRS's standard Terms and Agreements.

Plaza defaulted at some point after the suretyship document was executed by Defendant Herklotz. Without notice to surety, Defandant Herklotz, WRS and Plaza principals entered into a "Services Agreement" on October 12, 1998 that materially changed the creditor-debtor relationship. Instead of merely filling purchase orders for duplicating, manufacturing and fulfillment services of videotapes on a credit basis for Plaza, WRS would now perform management duties including, administering collection services, restocking services, generating sales invoices, monitoring and maintaining of bank accounts and a "lock box". With the execution of the Services Agreement, Plaza had relinquished control of its own ability to recoup profits to pay its debts or make decisions regarding marketing of its titles. Moreover, pursuant to the Services Agreement, Plaza was now charged a $5000/monthly fee and all of WRS's out-of-pocket expenses for administrative services that Plaza had handled itself when Defendant Herklotz signed the suretyship agreement.

It is indisputable that the Services Agreement is a substantially different agreement from the original agreement between WRS and Plaza, and that it significantly increases Defendant Herklotz's risk. Instead of being obliged to pay

Plaza's outstanding balance for WRS' duplication, manufacture and fulfillment services, Defendant Herklotz is now expected to pay for WRS' management of Plaza operations, for debts that WRS incurred while managing Plaza, for expenses associated with collecting Plaza's bills, marketing Plaza's surplus video titles, maintaining Plaza's bank accounts and for tracking Plaza's records. Defendant Herklotz's suretyship agreement never contemplated that Plaza's debts would be compounded by WRS's managerial control of Plaza and collection services on behalf of Plaza. Defendant Herklotz has met the requirements for complete discharge of a gratuitous surety's obligation under Pennsylvania law. As such, summary judgment must be granted in his favor.

In the event that this Court declines to fully discharge Defendant Herklotz's obligation, Defendant Herklotz prays that the Court will limit his obligation to the amount owed by Plaza as of the date that Plaza first defaulted on its payments to WRS, if that date can be ascertained and if that figure can be reasonably calculated. Defendant Herklotz respectfully asserts that the date cannot be determined and the figure cannot be reasonably calculated.

II. WRS's Alleged Damages Cannot Be Reasonably Calculated

WRS's proof of damages is muddled and confused due to poor record-keeping, failure to produce documentation, or its inability to produce documentation because records were never maintained in the first instance, that its damages cannot be reasonably calculated. The Plaintiff in an action for breach of contract has the burden of proving damages resulting from the breach. Spang v. U. S. Steel Corporation, 545 A.2d 861 (Pa. 1988). Further, as a general rule, damages are not recoverable if they are too speculative, vague or contingent and are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty. *Restatement (Second) of Contracts*, § 352; *Murray on Contracts*, § 226.

As demonstrated in specific examples above, WRS cannot demonstrate the amounts owed by Plaza and when. An occasional invoice is not enough. WRS has produced no report prepared by an accountant or forensic accountant who might provide an accurate determination of damages.

When pressed as to why the records and documents that were produced in this lawsuit are so unorganized, Jack Napor testified:

> A. The reason it is not part of one neat package, John, is that there were a lot of people who have been through [the documents produced] including Mr. Herklotz and his attorney in the beginning, and this stuff has been shuffled back and forth and moved and disorganized and I haven't taken the time to put it in, and I thought once we gave you what you asked for perhaps one of your staff would have put it together sequentially by date;

(Napor Depo., p. 111:12-21),

and further:

> A. Over the time, and we haven't been a fully functional business, it is a 200,000 foot building with a lot of stuff in it and I have a handful of employees, we are liquidating equipment, consolidating accounts, cleaning up space, so we can liquidate, and somewhere along the line we have lost track of some of the paperwork because I remember it being much more voluminous than we have now, but I also don't think there is anything in there that is germane. I think all the important stuff is here.

(Napor Depo., pp. 107:23-25, 108:2-10).

WRS has the burden to prove its damages in a contract case. The Court cannot rely on spotty record keeping (certainly when WRS was charging Plaza and increasing Defendant Herklotz's risk of obligation for record-keeping services), and self-serving statements and recollections of WRS's President such as "all the important stuff is here". WRS must come forward with an organized, documented and reasonable calculation of damages. WRS has failed to do so. As such, WRS cannot prove a material element of breach of contract action. In addition, WRS has made no accounting whatsoever of amounts that it received in payments from customers and for returns, the existence of which is undisputed.

CONCLUSION

Since the October 12, 1998 Services Agreement materially modified the relationship between Creditor WRS and Debtor Plaza, increasing Defendant

Herklotz’s risk of obligation, Defendant Herklotz’s suretyship is discharged, and because WRS’s alleged damages are incapable of reasonable calculation, Defendant Herklotz is entitled to summary judgment on all counts against him as a matter of Pennsylvania law.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the within **Brief in Support of Motion for Summary Judgment or, Alternatively, Motion for Partial Summary Judgment** has been served on counsel listed below by electronic mail on this 24th day of February, 2006:

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